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PLANNING IN AN IMPORT-SENSITIVE ECONOMY

By Ignacy SACHS, Ph.D.,
Acting Director,
Center of Research on Underdeveloped Economies,
Warsaw

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PLANNING IN AN IMPORT - SENSITIVE ECONOMY

by Ignacy Sachs, Ph.D.

Acting Director, Center of Research

on Underdeveloped Economies, Warsaw

1. The developing countries, taken as a whole, are facing a severe "trade gap": the average annual rate of growth of their exports has been lagging far behind the rate of expansion of imports. During the years 1953-60 the developing countries increased their imports at a rate of 5.5 per cent per annum, i.e. faster than the growth of national income, which may be put at 3.5-4 per cent, while exports hardly kept pace with the national income, faring 3.5. per cent per annum. Exports from developing countries cover at present only about 90 per cent of their imports, leaving an uncovered gap of 10 per cent of merchandise imports without mentioning the heavy deficit on the remaining posts of the balance of payments.

1.1. Such a situation arises fundamentally from the combined effect of two factors:

/i/ the lack of sufficient demand on the world capitalist market for several traditional export-goods produced by the developing countries, which accounts also for the adverse trend in the terms of trade, and

/ii/ the mounting pressure on the import bill of developing countries, on account of development programmes as well as of unsatisfactory internal supply of food and fuels, magnified by the high rates of population increase.
It should be noted that up to now no significant transfers of capital from the developed to the less developed countries have taken place: the so-called "net flow of long - term capitals" /which includes also re-ploughing of profits made by foreign companies/ hardly matches the outflow of capital from the less developed countries in form of expatriated profits of foreign capitalists, losses suffered on account of adverse terms of trade and placements made by capitalists from underdeveloped countries in banks abroad.

1.2. The situation described above has all the features of a structural inbalance. The traditional division of labour, evolved in the past century, proved to be a trap for the former colonial and dependent countries. They were forced into a narrow specialization, which made them heavily dependent on foreign trade in primary commodities. Such a trade never really succeeded to play the role of an "engine of growth". At best it lead to phases of lopsided development, alternated with periods of depression and crisis. Theoretically, during the years of plenty, imports of capital goods could have been

stepped up and industrialization carried over, but the relative abundance of foreign currency would rather induce the ruling elites to spend lavishly on luxury goods or to invest in the expansion of monocultures for export, thus paving the way to future crisis of overproduction, which were to hit them back through the price effect. Now that those countries are facing an unelastic world demand for their traditional exports, the need for industrialization has a much wider appeal, but foreign currency to pay for imports of capital goods is in short supply. Thus former "export-economies" /with the exception of a handful of producers of oil and some strategical materials, which are not of our concern in this paper/ became "import-sensitive economies". Industrialization is the only effective answer to their problems, as we shall see, and the only way to break through the strait-jacket of the unilateral division of labour, which has been forced upon them. But to achieve it, they have to start by increasing imports of capital goods; the foreign currency shortage becomes thus the most dangerous bottleneck, slowing down the overall rate of growth. The whole strategy of development must be subordinated to ease this bottleneck.

2. The planner has first to consider all the possibilities of increasing the earnings from exports.

2.1. We shall assume the existence either of stocks or of unitilized production capacity within the range of goods traditionnally exported. An export drive will not require therefore additional investment as long as the commodity pattern of exports remains unchanged. But ex definitione /we are speaking of import-sensitive economies / the demand on the world market is inelastic. Two possibilities must be examined however:

2.1.1. Even if the demand is inelastic, it is still possible to increase the volume of sales in the traditional markets by reducing the unit-price. This operation cannot be carried, however, beyond the point when the losses on unit price are bigger than the earnings obtained through the increase of the volume of sales. For a wide gamut of goods produced by less developed countries the actual market situation is such that it is preferable to protect the level of prices and renounce bigger sales, rather than to step up sales by depressing prices still more.

2.1.2. Some scope for increasing traditional exports exists by making headway into new markets. This is particularly true of the socialist countries. The trade between the socialist countries and the developing ones has been expanding at a rate of about 10 per cent per year during the years 1957-60, but it started some years ago almost from nil, so that the share of the socialist countries in the trade of the less developed countries does not exceed as yet 5 per cent. As for the intensification of commercial exchanges within the area of less developed countries themselves, it is bound to grow mainly in the field of non-traditional goods; the striking parallelism of production pattern in many less developed countries does not offer much room for an expanding mutual trade in traditionally exported primary goods. On the whole, the possibilities of immediate expansion on new markets with traditional export goods, though very commendable as it does not require special investments, are rather limited.

2.1.3. Some gains can be obtained by taking proper organizational steps, namely by establishing an effective state monopoly for sales

of main export products. Such a measure - when properly executed - strengthens the bargaining power of the exporter, makes easier the framing of long-range policies and the coordination of the foreign trade sector with the rest of the economy. In particular, the utilization of trade profits as a source of capital formation, or the granting of subsidies to exports, whatever the case may be, are made easier if exports /and for this case also imports/ are operated through State monopoly.

2.1.4. Finally mention should be made of some measures of international coordination and planning. Developing countries are vitally interested in the stabilization of prices for primary goods /strictly speaking of the stabilization of their ratio to industrial prices, i.e. of terms of trade/. But up to now all the multilateral schemes proved rather deceptive, as the leading industrial powers and the big monopolies feel very reluctant in giving up the profits made by manipulating the primary commodities prices. As for the so called compensatory financing schemes, they do not offer any protection against a long-run falling trend in primary prices. While efforts to make some progress in this field should not be abandoned, in the shorter run developing countries still have a less spectacular, but quite effective means of achieving some degree of stabilization and planning in the realm of exports of primary goods, by entering into long-term bilateral agreements and contracts. When combined with imports of capital goods on a credit basis, such agreements and contracts provide a very useful framework for the operation of foreign trade within a development plan.

2.2. We can now glance at the case for exports of non-traditional goods. We shall assume, for sake of simplicity, that they require investment, as no free capacity is available.

2.2.1. The capital available for investments in an underdeveloped economy being limited, the allocation of funds to an export-oriented project reduces the scope of investment oriented towards import-substitution. While no fixed rules can be drawn, it would seem that in equality of conditions /e.g. same gestation period, identical capital-output ratio and equivalent foreign-currency effect/ an import-substituting schema should be preferred to an export-oriented one, as it strengthens the economic independence of the country, while the export-oriented project, on the contrary, increases its dependence on the fluctuations of prices and volume of trade on foreign markets.

This observation should not be understood, however, as a plea for autarchy. We are discussing the case of an "import-sensitive economy", which struggles against difficulties in foreign trade so that it is bound to reduce its degree of dependence on it, while exploring to the outmost limit all the rational possibilities still open in that field. Moreover, in practice many export-oriented projects will prove more economical than alternative import-saving ones and then the choice will be obvious.

2.3.2. The probable <u>net</u> impact of an export-oriented project on the balance of payments should be carefully examined. Many mining investments, carried out by foreign private companies, prove e.g. self-defeating in this respect, as after having paid for the imports required by the company and its foreign staff and the profits expatriated by it, hardly any foreign currency is left for the exporting country. Once more one should point in this connection to the pat-

tern of trade referred to above in /2.1.4./: a mine equipped with foreign machinery imported on credit and repaid through deliveries of part of the current output of the mine, agreed upon in a long-term contract, might prove a very satisfactory deal to the developing country, mostly so if the newly extracted mineral was in short supply on the local market.

2.3.3. The scope for opening new quick-profit yielding lines of primary production for export being limited in the majority of countries by the availability of natural resources "easy" to explore and by the huge amount of necessary investment, the question arises to what extent developing countries could turn their attention to the production of industrial goods for export.
Prima facie such a goal should rather follow than precede the implantation of import-substituting industry. But several exceptions should be made:

/i/ in the case of a very small and rather backward country the dimensions of the internal market are so tiny that no modern industrial plant could be set, without engaging in selling part of its output on foreign markets. This calls for a close coordination between the developing countries of their blueprints for industrialization: the future of regional "common markets" in Latin America, Africa and Asia /or perhaps of broader schemes of economic co-operation between developing countries of different geographical areas /depends on the ability of the countries interested to find ways of establishing an effective international division of industrial labour, while mere taking of commercial measures, reducing or abolishing of customs tariffs etc. will not do;

/ii/ a few large developing countries, already engaged in a drive to build on their territory heavy industries may find it easier, for reasons of economies of scale, to plan from the very beginning plants with an output capacity exceeding the current demands of the local market, and turn at an early stage of industrialization to experts of heavy industrial products. Such a solution, perfectly legitimate from the point of view of these future industrial "giants" again requires careful international planning and close economic association between developing countries;

/III/ many hopes are voiced about the possibility of rapid expansion of experts of the so-called "cheap labour goods" from the developing countries to the highly industrialized ones. It would seem, however, that such possibilities have been greatly overstimated. The textile and the light engineering goods industrial are mushrooming all over the world in spite of excess capacity already existing both in developed and underdeveloped countries and there is hardly any room left for new Japans in the present international division of labour. On the other hand, one has to take a very careful view of the import-content of exported industrial goods. It may so happen e.g. that engineering goods shipped abroad and exchanged for non-essential goods, have a high import content paid for in hard currency; in such a case part of the non-essential imports is actually paid for in hard currency.

2.4. The cursory examination of export possibilities made above leads to the conclusion that for the great majority of "import sensitive economies" they are quite limited in the realm of primary

goods and, in the short and medium run, also in the field of industrial goods /except perhaps for substituting semi-processed materials for raw materials, e.g. pressing oil and selling oil and deoiled cakes instead of oil seeds/. This calls for a realistic and cautious assessment of the targets for increasing exports.

3. Once all the possibilities of increasing exports have been taken into consideration and capacity to import evaluated, the only way of increasing the overall rate of growth of an economy consists in reducing as much as possible the import co-efficient. Actually, it becomes a major criterion of evaluation for the planner, who has to frame the developmental plan in such a way as to achieve a fair measure of import substitution.

3.1. At this stage we should once more turn to organizational aspects of the problem and point to the necessity of establishing strict controls of imports /preferably through State monopoly of foreign trade/ in order to simply eliminate unessential imports of luxury-goods /the range of items banned from import lists being defined according to the standards of living of the working population and the capacity of the country to import/. Unessential imports constitute, however, for the planner a "reserve" which can only be used once.

3.2. Besides observing the rules of extreme austerity in imports of unessential goods, rigorous screening of all investment projects is called for, having in view:

/i/ the choice, ceteris paribus, of the project with the lesser foreign component. It is even admissible to increase the actual cost of the project, if effective cuts in imports are within sight. E.g. a country with unlimited supply of labour should choose traditional techniques of road construction rather than to import expensive road building machines. But considerations of shortening the gestation period of the investment may arise and on the other hand, the scarcity of wage-goods /foodgrains/ may put a check to the policy of increasing national income through extensive /and import-substituting/ employment of local labour[x]

/ii/ anti-import biased technological processes should be just the same preferred and local raw materials and skills utilized whenever available. In a longer and dynamic view, the reduction of the import coefficient implies, however, a sustained effort to create and expand the capacity of an economy for import substitution.

3.3. We shall first look at the possibility of achieving import substitution in different categories of goods imported.

3.3.1. For several underdeveloped countries food is a major item of imports. While it is possible to ban without any serious consequence the imports of spirits, expensive canned products etc. /the alternative being to put on them prohibitive duties/, imports of grain cannot be avoided as long as local agriculture is unable to meet the barest needs of the population. The lower is the economic condition of a country and the higher the income - elasticity of demand for grain; this elasticity can be put in many cases in the range of 0,6 - 0,8; the setting of an overall rate of growth of 5

[x] If there is not enough grain to meet the expanding purchasing power in workers hands, the country will run an inflation and real wages will decrease.

per cent per year implies that supplies of grain should increase therefore at 3.5 to 4 per cent year, if inflation is to be avoided. The rate of growth of grain production should be still higher if imports are to be eliminated at the same time.

Thus import substitution of grains is but an aspect of a broader problem, viz. that of achieving a fair rate of progress in agriculture and co-ordinating the rates of growth of the industry and of the whole economy with those of agriculture. Without going into this subject, we shall limit ourselves to remark that for a great number of developing countries this is the most difficult problem and that a deficient agriculture, hampered by obsolete institutional conditions, proves often to be the most serious bottleneck, jeopardizing the industrial drive and the whole developmental process.

3.3.2. Fuel resources are very unevenly distributed over the surface of the earth; while some of the developing countries are leading exporters of oil, others lack it /at least up to now production has not been started/ and import substitution in this particular field requires important pro-investment activities and afterwards huge investment with a relatively long period of gestation. No immediate import substitution is therefore possible, but several measures can be envisaged:

/i/ a proper commercial policy aimed at reducing the monopolistic position of the big oil-companies, may be instrumental in reducing the unit-price paid for oil;

/ii/ in some countries it might be advisable to start refineries, even if local oil is not as yet available;

/iii/ in countries with short supply of oil careful attention should be given to the proper choice of means of transport. In any case, imports of motor-cars for private use should be restricted /they certainly should fall under the category of luxury imports in many countries/.

3.3.3. Industrial consumer goods offer the broadest scope for a relatively quick import substitution, and therefore, should find a place of pride in the initial five-year plans of many developing countries. The planner should, on one hand, provide for "maintenance imports of raw materials and spare parts necessary for the existing industries often having iddle capacities and, on the other,for investments in light industries, yielding a high import-substitution effect, and relatively easy to master from the technical point of view. Three pitfalls should be avoided, however:

/i/ While collaboration with foreign firms might be considered as a transitory stage from assembling to setting into motion of the complete production, it is necessary to establish a rigorous time-table for the nationalization of the production; otherwise the cost of foreign components, the royalties paid to the foreign firms and the profits expatriated by foreign associates might well nullify the whole import substitution effect of the investment. The import substitution effect should be evaluated in terms of prices prevai-

vailing in international markets[x]

/ii/ if import-substitution concerns unessential goods /considered as luxury goods at the given stage of development of a given country/ this effect is purely apparent but not real. The setting of a factory turning out luxury goods leads to "immiserizing growth", which hampers economic development instead of promoting it, in spite of the fact that industrial output and employment go up: excessive employment in the production of superfluous goods may be assimilated with employment in domestic services for the elites, increasing the demnad for food and wage-goods without contributing an useful equivalent for, it while the supply of scarce capital goods, building materials, as well as raw materials prevents their utilization in a more productive way and slows down the rate of growth of essential industries. This is a phenomenon quite common in developing countries and should be paid careful attention by the planner;

/iii/ The emphasis in the first five-year plans on consumer goods industries bringing a quick improvement of the balance of trade should not be assimilated to a long-run strategy of development, perpetuating the dependence of developing countries on the heavy industries of leading economic powers. Such an attitude would amount to accept a new pattern of unequal economic relations between the fully and the uncompletely industrialized countries, as a substitute for the colonial pattern of relations between the industrial powers and the primary goods producers.

3.3.4. In the long run, continuous and effective reduction of import coefficient depends on the ability of a country to set up its own industry of producer goods. Only a strong capital goods industry, mainly machine-building industry and still more so machine-building industry turning out machines to build other machines - makes the rate of investment /and therefore of economic development/ relatively independent from the contingencies of world market. Thus considerations of balance of payment, besides those of employment, economic independence etc. give powerful support to the view that industrialization, as complete as possible, offers the only lasting solution to the problems of underdevelopment. Laying of foundations or expansion of producer goods industries should therefore be envisaged in any developmental plan, while the choice and the timing of different projects should be made dependent on such considerations like the size of the country, its natural enfowments, the degree of development of productive forces already achieved, the availability of skilled and semiskilled labour etc. Generally speaking certain big countries should engage as soon as possible in an intensive drive towards large-scale machine manufacturing, and whenever natural conditions are suitable towards production of iron and steel, while smaller countries with large supply of labour could well start by

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[x] The technique, currently adopted in several countries, of measuring the import-substitution effect by the share of value added domestically in the price ex factory is misleading: if a car assembled in a given country is "fifty per cent national", but its price ex factory is twice the CIF price of the same car imported, the import-substitution effect is nil.

setting certain machine - industries. The sequence of different projects should be carefully weighed. For instance, machine-tools industries should rather proceed than follow automobile plants etc.

3.4. A mixed strategy is thus necessary for the allocation of the import capacity and the setting of the investment programme, aimed at import-substitution. The planner has to recommend imports of raw materials, spare parts and certain single machine items for the existing industries working beyond full capacity and thus achieve immediate and real import-substitution effects, if the industries concerned do not turn out luxury goods. But this is a reserve which can /and certainly should/ be used once. If such industries of essential consumer goods do not exist as yet, they should be started in close relationship with the study of the changing pattern of consumption. It should be borne in mind, however, that after a period of five to ten years, the possibilities of achieving substantial import-substitution in the range of consumer goods will be nearing exhaustion, while the increasing rate of investments, /which start from a very low point/, coupled with the inexistence of capital goods industries gives continuous and expanding scope for import-substitution in the realm of producer goods[x].
Most certainly the planner will be shifting emphasis from one goal to another as the plan progresses and attaching different "weights" to them, according to the size and the potentialities of the country as well as to the degree of acuteness of foreign currency shortages. The alternatives he is concerned with, are but a specific case of the choice between higher immediate consumption at the expenses of the long-range rate of growth, and higher future consumption made possible through a higher rate of investments in the time-horizon envisaged by the plan. But the consideration of import-substitution provides another relevant dimension, aplicable also to the choice between two projects which in a closed economy would be identical from the point of view of short and long range effects on the national income. In an "import-sensitive" economy a project bringing more import substitution should be ceteris paribus always preferred.

3.5. The argument of comperative costs is frequently invoked in attempts to dismiss the case for import-substitution and, for that matter, the industrialization of developing countries. Such an attitude is based on two misconceptions:

/1/ the whole doctrine of comparative costs is static in its very essence. It fails to take a dynamic view of a country s endowments and also of costs of production. How can we speak of comparative advantages with relation to developing countries, if the bulk of their natural resources still lies iddle or is even unknown. Going back to the example quoted in /3.3.3./ it might so happen that the

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[x] In a closed economy, the rate of growth depends ultimately on the ability of building machines to build machines. In an expanding economy, faced by foreign trade difficulties, the rate of growth will increasingly depend on the ability of stepping up investments without increasing capital goods imports.

cost of production a given item is to-day twice as high in a factory just set in Africa, as in Western Europe, but to-morrow this gap may diminish or even disappear;

/ii/ besides, the argument of comparative costs may be applied as a criterion for short-run choice only to the extent to which the primary producer faces an elastic demand on world market for its traditional export goods, and this condition does not hold true, as we have seen, for the "import - sensitive economies".
There is no point, for the group of coffee - experting countries[x] to ascertain whether it would be more economical to increase coffee exports and to buy more machinery or to start to produce that machinery. An increased offer of coffee on the world market would depress still more the coffee prices, while the average costs of production could even increase by bringing under cultivation less fertil grounds.
The real choice is therefore: to start to produce machinery even at a high initial cost[xx] or to reduce the rate of investment even beyond the rate of savings by lack of available capital goods on the market. For an "import-sensitive economy" the consideration of absolute marginal cost of production of essential import-substituting goods /and of export goods/ becomes secondary to that of availability of those goods /provided of course that they are obtained at the lowest possible cost under given circumstances/.

4. The main conclusions emerging from this paper may be summed as follows:

/i/ For an "import-sensitive economy", where the lack of foreign currency limits the essential imports and indirectly the overall rate of growth, promotion of import-substitution becomes a major goal to be pursued by the planner. The lower the overall import coefficient the higher becomes the rate of growth compatible with a given import -capacity.

/ii/ The situation is somewhat analogous to that of capital - output ratios; by lowering them by means of relying on social effort, utilizing within certain limits traditional techniques, shortening of the gestation period, reducing the volume of construction by simplifying building structures, etc. it is possible to achieve a higher rate of investment with a given amount of capital.

/iii/ While it is common practice among planners to fix import coef-

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[x] The argument presented by us does not hold true for the utterly unrealistic case of an isolated action by a single and small producer. A sharp increase of coffee production by a marginal producer. A sharp increase of coffee production by a marginal producer would not affect the world prices and would give him some temperary advantage.

[xx] There is no reason why, on the long run, the costs of machine building industries should differ significantly from country to country. The concept of comparative advantage applies in the long run only to such industries like e.g. iron and steel where costs depend on the proximity of the sources of raw materials and considerations of costs of transportation assume paramount importance.

ficients just like the capital output ratios and to use them as constant parameters in models of growth, the methodological approach should be reversed: rather than to accept the import coefficients on basis of previous experience, international comparisons etc. their maximum reduction should be sought forsand erected into a criterion of evaluation of the plan, as well as of current economic policies.

/iv/ In an "import-sensitive economy" all the major bottlenecks of growth reflect themselves in the foreign trade position and, reciprocally, the lack of sufficient import capacity sharpens all contradictions of the economy. A careful consideration of the foreign trade implications of the proposed path of development, besides the direct indications for the investment programme, the organization of foreign trade and the trade polices, provides an opportunity for a cross-examination of the soundness of the whole plan.

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